

AR58



METROWERKS  
1996  
ANNUAL REPORT

## METROWERKS INC.

### FINANCIAL HIGHLIGHTS

FOR THE YEARS ENDED JULY 31, 1994, 1995 AND 1996

(in thousands of U.S. dollars, except per share amounts)

	July 31,		
	1994	1995	1996
<b>Earnings Information</b>			
Revenue	\$2,040	\$5,143	\$10,619
Net Earnings (Loss)	(332)	254	105
Earnings (Loss) Per Share	(0.05)	0.03	0.01
<b>Financial Position</b>			
Total Assets	1,692	6,634	18,305
Working Capital	(848)	4,742	13,519
Cash, Short-Term Deposits & Marketable Securities	767	4,746	11,498
Long-Term Debt	987	-	-
Shareholders' Equity	487	5,571	16,437
<b>Other Information</b>			
Avg. No. of Shares Outstanding	6,904	7,956	10,620
No. of Employees	43	67	120

#### MCU QUIZ

One of Metrowerk's growth markets is the embedded systems market, which includes consumer electronic devices with microcontroller units ("MCUs"). To better understand the opportunities available to Metrowerks in this large and growing market, take this short quiz.

**How many MCUs were sold in 1995?**

A. 300,000 B. 3 million C. 300 million D. 3 billion

**How many MCUs are in the average house?**

A. 1 B. 5-10 C. 50 D. as many as 100

(Both answers are D.)

The statements contained in this annual report include forward looking statements that involve a number of risks and uncertainties. Among the factors that could cause actual results to differ materially are the following: business conditions in the Macintosh-hosted software development tools market, competitive factors such as rival software development tools and price pressures, the success of the Company in entering new development agreements, software defects, product development and technological change.

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References to Metrowerks Inc. include Metrowerks Inc. and its 100% owned subsidiaries Metrowerks Corporation and Metrowerks Co., Ltd.

**W**elcome to Metrowerks' annual report for the fiscal year ended July 31, 1996 ("FYJuly96"). Metrowerks designs, develops, markets and supports professional software development tools used by programmers to create software applications. Our principal product line, Metrowerks CodeWarrior®, consists of a suite of programming tools used by programmers worldwide to develop software in the C, C++, Pascal and Java™ programming languages. These languages are the most powerful and flexible languages available today and are designed to accomplish the most difficult programming tasks.

The key to success for any technology company is the people who make it happen. We have a fantastic group of people who share one vision: to bring to market the best programming tools in the world. Our employees have changed the industry by releasing CodeWarrior products three times a year (on a fixed schedule) since January 1994. Their ability to deliver major improvements to our software on a timely basis has enabled us to capture a dominant share of the Power Macintosh® market. We now employ over 125 people with offices in Austin, Montréal, Silicon Valley and Tokyo.

In FYJuly96, our revenues totaled \$10.6 million, an increase of 106% over our fiscal year ended July 31, 1995 ("FYJuly95"). Our growth in FYJuly96 was fueled by increased sales of our Power Macintosh programming tools.

What does the new fiscal year ending July 31, 1997, ("FYJuly97") hold for Metrowerks? In FYJuly97, we hope to:

- 1. Maintain our dominant marketshare in the Power Macintosh programming tools market;**
- 2. Expand more aggressively in the embedded systems tool market by continuing to target specific proprietary embedded operating systems ("OS"), such as the SONY® PlayStation™ and by offering support for multi-purpose real-time operating systems ("RTOS") which are widely available under license, such as Microware®'s OS-9® and**
- 3. Enter the Windows® market with the launch of Windows 95 and Windows NT™-based CodeWarrior products at Fall COMDEX® in November 1996.**

We increased our sales of Power Macintosh programming tools 79% in FYJuly96 over FYJuly95, in spite of the media feeding frenzy over the future of Apple Computer. We believe that the Power Macintosh programming tools business is an extremely viable business that we intend to pursue aggressively. Our registered

user base increased in FYJuly96 from approximately 20,000 total registered users to over 50,000 users.

Until now, our efforts in the embedded systems programming tools market have focused on supporting proprietary operating systems such as the SONY PlayStation, the Magic Cap™ OS, PowerTV™ and the Palm OS™ used in the Pilot™ device from U.S. Robotics. In FYJuly97, we intend to penetrate the embedded systems market with the launch of new CodeWarrior products supporting multi-purpose embedded real-time operating systems such as Microware's OS-9.

In November 1996, we intend to introduce a line of products for the Windows 95 and Windows NT ("Win95/NT") operating systems at COMDEX. Our entry into the Win95/NT programming tools market has two focused objectives: 1) to reinforce our embedded systems strategy by offering potential customers embedded programming tools hosted on both Mac™ OS and Win95/NT desktop computers, and 2) to gain access to the largest programming tools market in the world.

In the pages that follow, we hope to accomplish the following:

- 1. Outline how we intend to enter new markets;**
- 2. Explain how our engineers have designed CodeWarrior products to meet these market opportunities;**
- 3. Detail the infrastructure changes we have made in FYJuly96 to position ourselves for the future; and**
- 4. Outline our financial performance in FYJuly96.**

We hope you enjoy this annual report. If you have any further questions about Metrowerks, please feel free to contact us at our e-mail addresses below, or call us anytime at 512-873-4700.

Your Management Team,

Khurram Qureshi, Director, Technical Support	khurram
Berardino Baratta, Vice President, Research & Development	baratta
David Perkins, Senior Vice President, Strategic Products	perkins
Greg Galanos, President & Chief Technology Officer	galanos
Jean J. Bélanger, Chairman & Chief Executive Officer	belanger
Jim Welch, Vice President, Finance & Chief Financial Officer	welch
Rob Geier, Vice President, Sales	geierm
Eileen Schaubert, Director, Marketing	eileen

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## The Market Opportunities Facing Metrowerks

Metrowerks develops and sells programming tools which are sometimes referred to as "hard-core" programming tools. The market for software development tools can be segmented into two very distinct markets:

1. **Hard-core tools, similar to those which Metrowerks develops and markets; and**
2. **Database extraction tools, such as Visual Basic® and PowerBuilder®, which is a market Metrowerks does not directly participate in.**

Hard-core tools are used to write software which uses the least amount of RAM and executes user commands as fast as possible. Hard-core tools usually feature any one of three widely-used languages: C, C++ and Object Pascal. Increasingly, hard-core programmers are looking at Java, the new programming language developed by Sun Microsystems. CodeWarrior Gold™ includes the C, C++, Object Pascal and Java programming languages. Metrowerks' programmer customers can switch between any of these languages, depending on what they are trying to accomplish. CodeWarrior Gold is the only widely-used desktop programming product on the market today that features all of these languages in a single package.

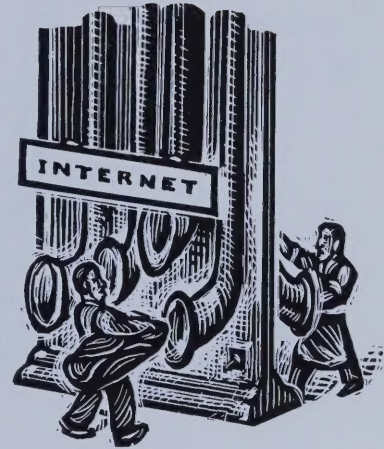
The markets for hard-core programming tools can be characterized by where the software being developed will be deployed:

1. **On a Macintosh™ or similar PowerPC™-based Mac OS clone;**
2. **On an Intel® x86-based clone running any of the current Microsoft® Windows operating systems, especially Windows 95 or Windows NT; and**
3. **On an electronic device or system which is not a desktop computer. This represents a vast array of devices, or "embedded systems," as simple as a digital clock or as complex as a satellite.**

The following table outlines the number of programmers in the world who use hard-core programming tools in these three markets:

Mac OS	200,000	7%
Embedded Systems	1,050,000	40
Windows	1,400,000	53
Total	2,650,000	100%

Source: Metrowerks Estimates 1996  
Dataquest Inc.



In FYJuly96, 68% of Metrowerks' total revenue was derived from sales of Macintosh programming tools. Metrowerks' further penetration in the embedded systems market and entry into the Windows 95/NT market dramatically increases the market opportunities facing the Company.

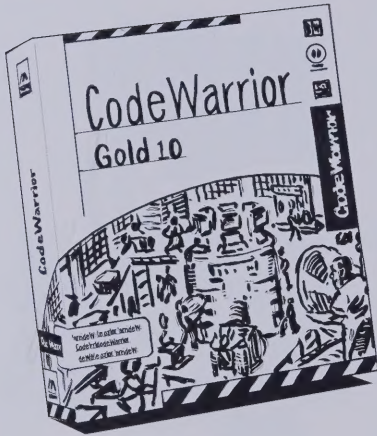
## Mac OS Market

Metrowerks increased its sales of Macintosh programming tools 79% in FYJuly96 over FYJuly95, in spite of the media feeding frenzy over the future of Apple Computer. The Company's registered user base increased in FYJuly96 from approximately 20,000 total registered users to over 50,000 users.

Apple Computer's new management continues to make important changes to Apple, and Metrowerks expects this to continue throughout FYJuly97. The Company does not expect to see any dramatic increase in Apple's market share in FYJuly97. The growing number of Mac OS-based clone manufacturers may increase the Mac OS's share of the overall desktop computer market, but this will take time. Without an increase in the Mac OS's market share, Metrowerks does not believe that it will see any dramatic increase in its Mac OS-based sales.

The Power Macintosh programming tools business is an extremely viable business that Metrowerks intends to sustain and improve aggressively. While the Mac OS tools market is smaller than the embedded systems market and the Windows market, it provides Metrowerks with the critical mass needed to move forward into these larger markets. Few programming tool companies in the world have as many registered users as Metrowerks. The Company's 50,000+ registered Macintosh users represent many of the world's finest programmers and, as such, Metrowerks is privileged to have access to their feedback on an on-going basis. The Macintosh market has led the world in many areas, especially graphical user interface ("GUI") design. Metrowerks believes its fully GUI-based CodeWarrior Integrated Development Environment ("IDE") is one of its most important strategic competitive advantages as the Company moves into new markets, especially in the embedded systems market, where many programmers are still using command-line tools.

In FYJuly95 and early FYJuly96, Metrowerks began to see a definitive market trend: more and more people wanted to learn about programming. Traditionally, however, hard-core programming tools have been expensive and inaccessible to those who want to know how to program. As a result, the Company introduced an entry-level product line, Discover Programming.™ These products, priced under \$100, include CodeWarrior development tools, interactive learning aids and online books.



Discover Programming products require modest investments in research and development because they use existing CodeWarrior tools. In FYJuly96, the Company launched two such products: Discover Programming for Macintosh and Discover Programming with Java. In the last ten months the Company has sold over 10,000 copies. Given this success in FYJULY96, the Company intends to extend the Discover Programming line to include new products for the embedded systems and Windows 95/NT markets.

## Embedded Systems Market

How big is the embedded systems market? Nothing illustrates the size of the embedded systems market better than the fact that three billion microprocessors, known as microcontroller units, or "MCUs," were shipped in this market in 1995. In comparison, the overall computer industry consumed less than 100 million microprocessors, known as microprocessor units, or "MPUs." MPUs are used in computers and in complex electronic devices.

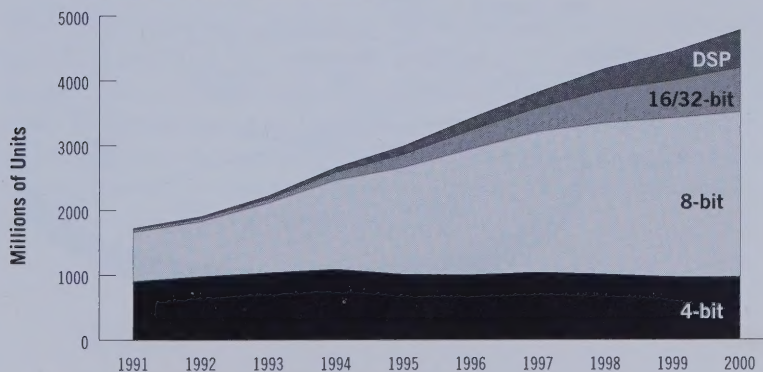
### MCUs & MPUs Shipped in 1995 (in millions)

	MCU		MPU	
	Units	Sales	Units	Sales
4-bit	1,009	\$1,750	—	\$ —
8-bit	1,650	5,789	50	195
16/32-bit	196	1,795	152	13,753
<b>Totals</b>	<b>2,855</b>	<b>\$9,304</b>	<b>202</b>	<b>\$13,948</b>

Source: Integrated Circuit Engineering Corporation (ICE)

In the embedded systems market, Metrowerks is targeting the 32-bit MCU market, one of the fastest growing segments:

### Worldwide MCU Shipments by Category



Source: Integrated Circuit Engineering Corporation (ICE)

### Worldwide MCU Shipments by Category (in millions)

	'91	'92	'93	'94	'95	'96	'97	'98	'99	'00
<b>4-BIT</b>	906	979	1036	1089	1009	1000	1038	1008	967	964
<b>8-BIT</b>	753	843	1073	1373	1650	1943	2173	2339	2454	2548
<b>16/32-BIT</b>	39	46	60	120	196	283	366	503	580	685
<b>DSP</b>	24	34	52	77	134	193	247	339	448	589
<b>TOTAL</b>	1722	1903	2221	2659	2989	3420	3824	4189	4449	4787

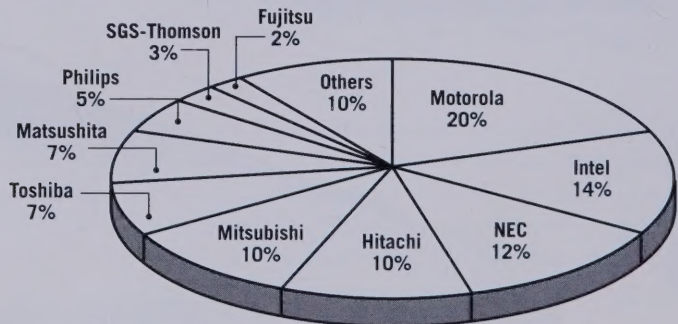
Source: Integrated Circuit Engineering Corporation (ICE)

The bulk of the embedded systems market is comprised of 4/8-bit MCUs used in a variety of day-to-day devices such as VCRs, microwave ovens, etc. These 4/8-bit MCUs are usually programmed in assembly languages, and, therefore, are not target markets for Metrowerks. The use of 16/32-bit MCUs is growing much faster than that of 4/8-bit MCUs because of the dramatic decrease in the cost of 16/32-bit MCUs in the past few years.

One of the most interesting developments in the microprocessor market in 1996 has been the emergence of new, relatively low-cost digital signal processors ("DSPs"), which are powerful enough to process 3-D graphics, full-motion video, etc. In 1997 and beyond, it is likely that multi-media computers will contain both a powerful CPU and a DSP. Metrowerks is studying this market because desktop computer applications would have to be recompiled to take advantage of the processing power of these new DSPs.

In contrast to the desktop computer market, where Intel is the dominant supplier, the markets for MCUs is highly fragmented:

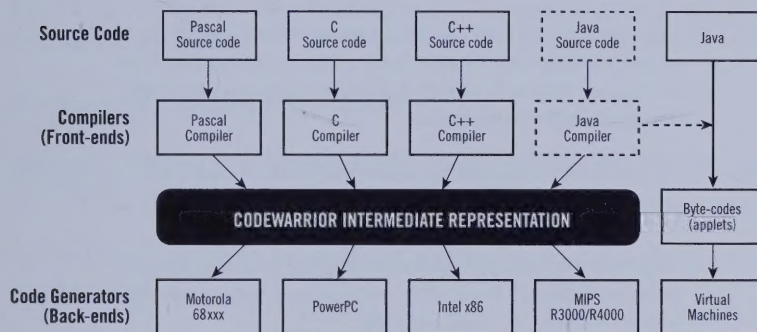
### Leading MCU Suppliers\* 1995 (est.) Market Share



Source: Integrated Circuit Engineering Corporation (ICE)

Total Market Value \$9.3B  
\*Excluding DSP sales.

Metrowerks believes one of its major competitive advantages in the embedded systems market is CodeWarrior's ability to support multiple microprocessors with modest incremental investments in research and development. This is achieved by the innovative design of CodeWarrior development tools:



Once a programmer has finished writing an application, the CodeWarrior language front-end compiles the program listing (source code) into a CodeWarrior Intermediate Representation ("CWIR"). The CodeWarrior back-end code generator converts the CWIR into executable code for a specific microprocessor and operating system (target platform).

CodeWarrior's architecture gives Metrowerks two competitive advantages:

1. **Reduced research and development expenses.** If Metrowerks adds support for a specific MCU or MPU, only a new back-end code generator and linker needs to be developed. The language front-ends do not have to be rewritten.
2. **Rapid deployment.** Given that a new language front-end does not have to be rewritten every time Metrowerks adds support for a new MCU or MPU, time-to-market is greatly reduced.

Given these advantages afforded by CodeWarrior's architecture, Metrowerks believes it is one of the lowest-cost providers of compiler technology for multiple MCUs and MPUs in the industry. Taking advantage of these economies of scale, Metrowerks has priced its CodeWarrior products for embedded systems significantly below the competition. Metrowerks has priced its embedded systems products from \$299 to \$499 per programmer. Currently, most comparable tools for embedded systems retail for \$3,000 and up per programmer.

The embedded systems programming tools market can be divided into two distinct segments:

1. **Proprietary operating systems which are developed by a systems vendor for a specific device.**
2. **Multi-purpose real-time operating systems ("RTOS") which are widely available under license. Three of the most important RTOS vendors are Microware with OS-9, Integrated Systems with pSOS® and Wind River with VxWorks®.**

Metrowerks entered the embedded systems market in FYJuly95 and now supports several proprietary operating systems:

1. **Magic Cap OS, developed by General Magic for hand-held devices using the Motorola® 68349 MCU, which are manufactured by systems vendors including Motorola and SONY;**
2. **PowerTV OS, developed by PowerTV, a subsidiary of Scientific Atlanta, for deployment in TV set-top boxes using PowerPC™ MCUs;**
3. **Palm OS, developed by U.S. Robotics to run their new Pilot hand-held organizers using the Motorola 68328 MCU; and**
4. **PlayStation OS, developed by SONY to run the SONY PlayStation game console using the MIPS® R3000 MCU.**

The most recent proprietary operating system to be supported by Metrowerks is the PlayStation OS. The first version of CodeWarrior for PlayStation will ship in October 1996 and will mark the Company's entry into the mainstream consumer electronics market, a vast consumer of MCUs.

In September 1996, Metrowerks announced support for Microware's OS-9 on PowerPC. This is the first multi-purpose RTOS Metrowerks will support. This will significantly expand the market potential for Metrowerks' embedded systems products. Vendors of multi-purpose RTOSes are experiencing rapid growth because electronics vendors are increasingly relying on multi-purpose RTOSes for the following reasons:

1. **Reduced costs.** Many electronics vendors are finding that it is less expensive to license a multi-purpose RTOS and pay a per copy royalty fee than to develop their own propriety operating systems;
2. **Reliability.** Multi-purpose RTOSes have been deployed in thousands of different electronic devices and, thus, have been extensively debugged and field-tested; and

**3. Time-To-Market. By deploying a multi-purpose RTOS, an electronics vendor can save valuable time in getting its products to market.**

Metrowerks will continue to aggressively pursue the embedded systems market because the Company believes that it has significant competitive advantages which it can deploy and there is currently no single dominant provider of programming tools in this market.

## **Windows 95/Windows NT Market**

Metrowerks intends to introduce a line of Windows 95 and Windows NT ("Win95/NT") products at COMDEX in November, 1996.

The Company's entry into the Win95/NT programming tools market has two focused objectives:

- 1. Reinforce its embedded strategy by offering potential customers embedded programming tools hosted on both Mac OS and Win95/NT desktop computers; and**
- 2. Gain access to the largest programming tools market in the world.**

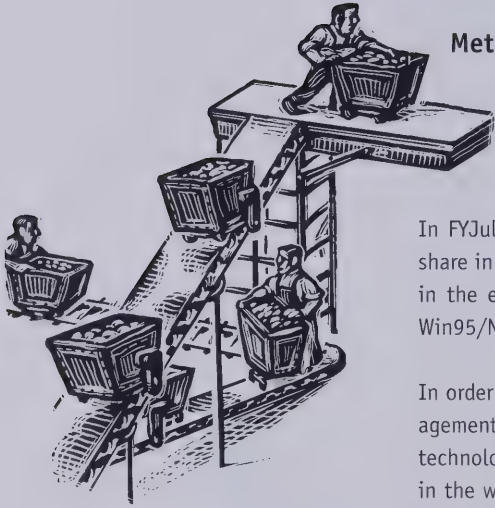
The first objective Metrowerks has in entering the Windows-hosted programming tools market is to offer its embedded systems tools customers the choice of hosting the embedded tools on either Mac OS or Win95/NT computers. This allows electronics vendors to choose the computer which best suits their needs.

The second objective Metrowerks has is to gain entry to the largest tools market in the world.

The Win95/NT "hard-core" programming tools market is dominated by Microsoft Corporation, which produces Visual C++®. The second most important vendor in the Win95/NT market is Borland International, which offers a number of hard-core tools including Borland C++™ and TurboPascal™. Other competitors include Watcom, which publishes Watcom™C/C++, and Symantec Corporation, with Symantec®C++ for Windows.

The Win95/NT programming tools market will be a difficult market for Metrowerks to penetrate. However, Metrowerks does not plan to compete directly with existing vendors, but will instead promote its cross-platform tools to developers who create programs for more than one platform.

Metrowerks will be the only major desktop computer vendor in the Windows market to offer support for multiple microprocessors in one product under \$500. As more and more electronic devices become dependent on software for their market success, Metrowerks believes users will be looking for a low-cost multi-platform solution.



### **Metrowerks' Future Growth Prospects**

Given the size of the Mac OS, embedded systems and Win95/NT markets, Company management believes Metrowerks has an opportunity to grow for the foreseeable future.

In FYJuly97, Metrowerks will concentrate on maintaining its dominant market share in the Mac OS market and aggressively pursuing the opportunities present in the embedded systems market. The Company will begin its entry into the Win95/NT market using its cross-platform strategy to its best effect.

In order to grow effectively, Metrowerks has expanded and reorganized its management team, opened offices in Silicon Valley and Tokyo and cultivated strategic technology partnerships with some of the most important electronics vendors in the world.

### **Administration**

A growing customer base and the opportunity to enter new markets led Metrowerks to increase its staff from 67 employees at the end of FYJuly95 to 125 employees at the end of FYJuly96. Sixty-five employees are in the research and development group. In April 1996, Metrowerks moved to a new, larger location in Austin. In addition to increasing its office space, Metrowerks implemented an integrated accounting, sales order processing and customer database system.

With Metrowerks moving into new markets, relationships with strategic partners are increasingly important. As a result, in FYJuly96, Metrowerks decided to establish a full-time presence in Silicon Valley, home to many of the world's largest electronics and software vendors. In addition, Metrowerks decided to open a subsidiary, Metrowerks Co., Ltd., in Tokyo in October 1996. The Tokyo office will oversee marketing and sales efforts in Japan, Metrowerks' largest user base outside of the United States. The subsidiary will also work closely with the Company's Japanese partners, especially the consumer electronics companies located in Japan.

Metrowerks made a number of management additions and changes in FYJuly96:

Greg Galanos, age 38, founded Metrowerks in 1985. Mr. Galanos was the Company's President and Chief Executive Officer from 1985 until September 1996. Mr. Galanos has relocated to Silicon Valley to more closely manage relationships with the Company's most important strategic partners located in California, including Apple Computer, Microsoft Internet Platform Groups, Sun Microsystems, Be Inc., General Magic, and U.S. Robotics. As a result of the move, Mr. Galanos changed his title to President and Chief Technology Officer. Mr. Galanos will continue to oversee the Company's research and development efforts. Mr. Galanos earned an M.Sc. (Computer Science) from the University of Quebec at Montreal.

David Perkins, age 34, joined Metrowerks in May 1995, as Vice President, Finance and Chief Financial Officer. Given the Company's intended entry into the mainstream embedded systems market, Mr. Perkins was appointed Senior Vice President, Strategic Products and will head the Company's efforts in this critical market. Prior to joining Metrowerks, Mr. Perkins was an audit partner for four years with Coopers & Lybrand Montreal. At the time of his appointment as audit partner, Mr. Perkins was the youngest partner of Coopers & Lybrand in Canada. Mr. Perkins earned a B.Comm. from McGill University and is a Chartered Accountant. Mr. Perkins is located in Austin.

Jim Welch, age 30, is Vice President, Finance and Chief Financial Officer. Before joining Metrowerks in June 1996, Mr. Welch was a Senior Manager at Coopers & Lybrand L.L.P. in Austin. He is a CPA and earned his B.B.A. from The University of Texas at Austin. Mr. Welch is located in Austin.

Berardino Baratta, age 26, is Vice President, Research and Development. Mr. Baratta joined Metrowerks in 1992 and played an essential role in the early stages of development of CodeWarrior development tools, the Company's flagship product line. Mr. Baratta earned a B.Eng., with Honors, from McGill University in Montreal. Mr. Baratta is located in Austin.

Jean J. Bélanger, age 42, became Chairman of Metrowerks in 1989 and joined the Company full-time in that capacity in 1991. With Mr. Galanos' relocation to Silicon Valley, Mr. Bélanger became Chairman and Chief Executive Officer at the Company's principal offices in Austin, Texas. Mr. Bélanger earned an M.Sc. (Finance) from the London School of Economics and a B.Comm. from the University of Ottawa, and is a Chartered Accountant.

Rob Geier, age 41, is Vice President, Sales. Prior to joining Metrowerks in June 1996, Mr. Geier held a number of executive sales and marketing positions with MicroWarehouse, JWP Information Services and Unisys. Mr. Geier earned a B.A. and MBA from the University of Connecticut. Mr. Geier is located in Austin.

Khurram Qureshi, age 25, is Director, Technical Support. Mr. Qureshi joined Metrowerks in May 1994. Prior to joining the Company, Mr. Qureshi earned a B.S. (Electrical Engineering) from The University of Texas at Austin. Mr. Qureshi is located in Austin.

Eileen Schaubert, age 33, is Director, Marketing. Ms. Schaubert joined Metrowerks in July 1995. Ms. Schaubert earned a B.Eng., with Honors, from The University of Minnesota and an MBA from The University of Texas at Austin. Prior to obtaining her MBA, Ms. Schaubert was a new product engineer at Hewlett-Packard. Ms. Schaubert is located in Austin.

### Strategic Partnerships



Metrowerks expands its technology and strengthens its position as a leading programming tools vendor through strategic agreements with some of the leading electronics and software vendors in the world.

In October 1994, Metrowerks agreed with Be, Inc. to develop and sell a full set of CodeWarrior tools hosted on the BeOS.™

In April 1995, Metrowerks announced an agreement with Microsoft to bring Microsoft's cross-platform Visual SourceSafe™ version control technology to the Macintosh platform. Metrowerks CodeManager™ was introduced in January 1996 and provides Macintosh programmers with a version control system that is compatible with Visual SourceSafe, which is widely-used among Windows developers.

In June 1995, Metrowerks announced an agreement with Scientific-Atlanta to develop and sell a full set of tools used to develop software for the PowerTV OS.

In May 1996, Metrowerks and Microsoft signed an agreement in which Metrowerks would provide Microsoft with Java technology for use in Microsoft Internet Explorer on Mac OS.

In June 1996, Metrowerks announced an agreement with Motorola's High Performance Embedded Systems Division to extend the CodeWarrior development environment to include support for Motorola's MPC8xx PowerPC family of embedded MCUs. In September 1996, Metrowerks announced an agreement with Microware to extend support for the OS-9 RTOS.

In FYJuly96, Metrowerks continued support for the Magic Cap OS and introduced support for the Pilot hand-held organizer. In August 1996, Metrowerks announced an agreement with Sony Computer Entertainment Inc. to develop and sell a set of authorized tools for developing PlayStation game console software.

In FYJuly96, Metrowerks and Powersoft announced an agreement enabling Powersoft to license a special version of Metrowerks' CodeWarrior C/C++ compilers and linkers. These CodeWarrior tools will be shipped as shared libraries in PowerBuilder, becoming an integrated part of the PowerBuilder code generator engine for the Macintosh platform.

## Conclusion

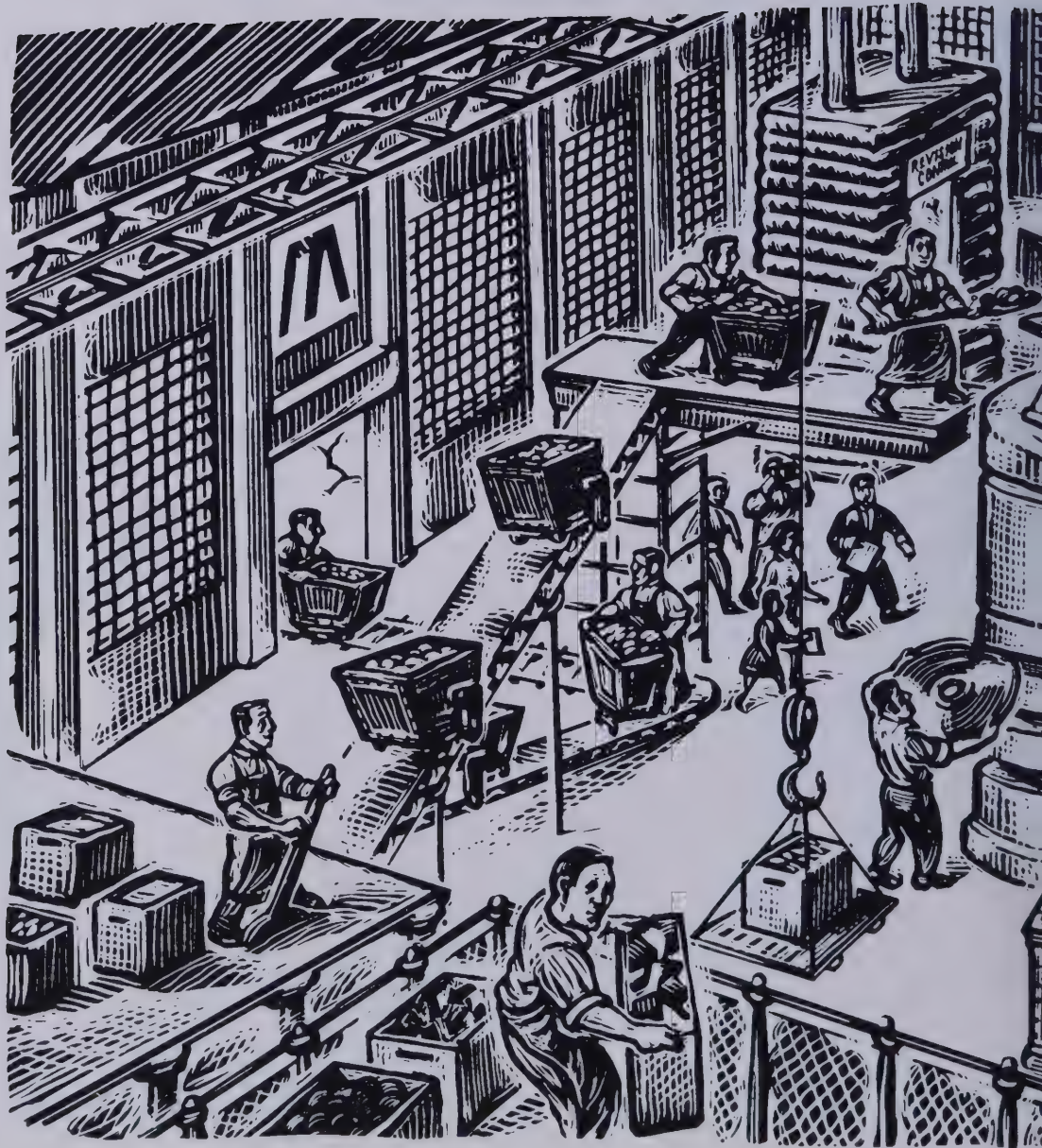
The world is becoming more software intensive. It is difficult to buy an electronics product today which does not have a significant software component. Regardless of the device, programming tools are needed to write the software. Metrowerks fully expects to be in a position to capitalize on this growing trend in the industry.

Contrary to what most people think, software is a capital-intensive business - equity capital, that is. The access to capital that the public markets in Canada and the United States have provided to Metrowerks has been an integral part of the Company's success in penetrating the hard-core programming tools market. The management and employees of Metrowerks sincerely thank all of the investors who have displayed confidence in the Company by buying its common shares. In order for Metrowerks to provide a rate of return for its investors, the Company recognizes that it must grow its business. Metrowerks hopes that this annual report has outlined to its shareholders how the Company intends to achieve this growth.



**Jean Bélanger**  
Director

**David Perkins**  
Director





# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Selected Financial Information

	Year Ended Dec. 31, 1992	Seven Months Months Ended July 31, 1993(2)	Year Ended July 31,		
			1994	1995	1996
(in thousands of U.S. dollars, except per share data)					
<b>Statement of Operations:</b>					
Revenue	\$190	\$105	\$2,040	\$5,143	\$10,619
Direct costs	70	4	207	827	2,389
Gross margin	120	101	1,833	4,316	8,230
Operating expenses:					
Research and development	358	365	1,080	1,657	3,525
Selling, administrative and technical support	195	137	1,053	2,348	4,622
Depreciation of property and equipment	11	8	66	155	355
Total operating expenses	564	510	2,199	4,160	8,502
Earnings (loss)					
from operations	(444)	(409)	(366)	156	(272)
Other income (expense):					
Interest income	—	—	20	93	375
Interest expense	(28)	(21)	(35)	(35)	—
Other	46	10	49	40	2
Earnings (loss) before income taxes	(426)	(420)	(332)	254	105
Recovery of income taxes	21	—	—	—	—
Net earnings (loss)	<u>\$(405)</u>	<u>\$(420)</u>	<u>\$(332)</u>	<u>\$254</u>	<u>\$105</u>
Net earnings (loss) per share (1)	<u>\$(0.07)</u>	<u>\$(0.07)</u>	<u>\$(0.05)</u>	<u>\$0.03</u>	<u>\$0.01</u>
Weighted average number of common shares outstanding(1)	5,742	6,336	6,904	7,956	10,620

(in thousands of U.S. dollars)

	July 31		
<b>Balance Sheet:</b>	1994	1995	1996
Cash, short-term deposits and marketable securities	\$767	\$4,746	\$11,498
Total assets	1,692	6,634	18,305
Long-term debt, less current portion	785	—	—
Total stockholders' equity	487	5,571	16,437

(1) For an explanation of the determination of the number of shares used in computing per share amounts and the weighted average number of Common Shares outstanding, see Note 2 to the Financial Statements.

(2) In October 1993, the Company changed its fiscal year end from December 31 to July 31. As a result, the historical fiscal 1993 period consists of seven months.

All dollar amounts referred to in management's discussion and analysis are stated in thousands of U.S. dollars.

## Overview

Metrowerks designs, develops, markets and supports software programming tools. The Company's products are used primarily by professional software programmers, and by programmers in the academic community, to develop applications software for a variety of platforms, including the Mac OS operating system running on the Macintosh and Power Macintosh computers and the Windows 95 and Windows NT operating systems running on PCs. The Company has also developed versions of its principal programming tools that can be used by programmers to develop application software for the MagicCap operating system used by certain hand-held computers, for the Be operating system used by the Power PC-based BeBox desktop computer, for the Pilot operating system used by US Robotics Pilot, for the Power TV operating system used by Scientific Atlanta in set top boxes and for the PlayStation operating system used by the Sony PlayStation game console.

The Company derives substantially all of its revenue from a limited number of products. The Company's future revenue is substantially dependent upon the continued acceptance of its CodeWarrior products. The Company is also in the process of developing a number of new products and believes that its future revenue will depend upon the commercial success of these new products.

The Company also derives a significant portion of its revenue from third-party software development agreements, pursuant to which the Company receives payments from a third-party for developing programming tools for a particular platform, operating system or programming language. The amount of revenue the Company receives from this particular source will depend upon the number of such agreements to which the Company is a party and the payment schedules under such agreements. Further, there can be no assurance that the Company will be able to continue to enter into such development agreements in the future. The Company's product development efforts have also entailed significant research and development expenditures. In addition, to enhance its competitive position in the future, it will be necessary for the Company to broaden its product offerings. This objective may require expansion of the Company's internal product development efforts or acquisitions of or investments in complementary businesses, products or technologies. These fluctuations in revenue could affect the Company's quarterly and annual results and result in fluctuations in its operating results. The Company intends to continue to invest significant amounts in expanding its product line and, accordingly, may continue to experience losses and volatility of revenue and operating results in future periods.

On August 1, 1995, the Company adopted the United States dollar as its reporting currency, and the consolidated financial statements have been restated to present amounts in United States dollars. Prior to August 1, 1995, the Company published its financial statements in Canadian dollars. In July 1993, the Company changed its fiscal year end from December 31 to July 31. As a result, the historical fiscal 1993 period consists of seven months. The Company believes that results for the seven-month 1993 fiscal year are comparable because the Company did not receive significantly higher revenue or incur significantly higher operating or other expenses for the 12 months ended July 31, 1993, compared with the seven months ended July 31, 1993.

## Results of Operations

The following table sets forth certain items from the Company's consolidated statement of income as a percentage of revenue for the periods indicated.

As a Percentage of Revenue

	Year Ended July 31,		
	1994	1995	1996
Revenue	100.0%	100.0%	100.0%
Direct costs	10.1	16.1	22.5
Gross margin	89.9	83.9	77.5
Operating expenses:			
Research and development	52.9	32.2	33.2
Selling, administrative and technical support	51.6	45.7	43.6
Depreciation of property and equipment	3.3	3.0	3.3
Total operating expenses	107.8	80.9	80.1
Operating income from operations	(17.9)	3.0	(2.6)
Other income (expense):			
Interest income	1.0	1.8	3.5
Interest expense	(1.7)	(0.7)	—
Other	2.4	0.8	—
Net earnings (loss)	(16.2%)	4.9%	0.9%

## Revenue

Revenues are comprised of the following:

Revenue	1994	1995	1996
Product revenues	1,469	4,044	7,246
Contract revenues	495	613	2,263
Hardware and other	76	486	1,110
	2,040	5,143	10,619

The Company recognizes revenue from the sale of its products upon the later of shipment or the satisfaction of all significant Company obligations, if any. Product returns are estimated and provided for at the time of sale. Such reserves as a percentage of revenue have varied significantly over recent years and periods, reflecting the Company's experience in product returns as it has significantly expanded the proportion of its sales through third-party distribution channels and increased its product portfolio. The Company expects that reserves will continue to vary in the future. The Company's agreements with its distributors generally provide the distributors with limited rights to return unsold inventories under a stock balancing program. The Company monitors activities of its distributors in an effort to minimize excessive returns and establishes its reserves based on its estimates of expected returns. Although the Company's returns historically have been within expectations, the setting of reserves requires judgments regarding such factors as future competitive conditions and product acceptance, which can be difficult to predict. The Company also derives revenue from non-recurring engineering fees. Non-recurring engineering fees related to software development are recognized ratably over the term of the contract, and are included in revenue in the income statement. Revenue, a substantial portion of which has been derived from sales of the Company's CodeWarrior professional programming tools, increased from \$2,040 in fiscal 1994 to \$5,143 in fiscal 1995 and increased 106% to \$10,619 in fiscal 1996. The increase in revenue in fiscal 1995 was the result of the development and release of new versions of the Company's products, and significant increases in the Company's sales and marketing personnel, distribution channels and marketing activities. The increase in revenues for fiscal 1996 is due in large part to an increase in product sales from \$4,044 in 1995 to \$7,246 in 1996. Sales of our flagship product, CodeWarrior Gold, improved due to a subscriber base increase from approximately 20,000 registered users at July 31, 1995, to over 50,000 at July 31, 1996 and to the continued penetration of the Power Macintosh development market. The introduction of new products, such as the Discover Programming series (including Discover Programming with Java), CodeWarrior for BeBox, and CodeManager, also contributed to the increase in product revenues from 1995 to 1996. Contract revenues for 1996 increased to \$2,263 from \$613 in 1995. The increase in contract revenues was the result of the Company's alliances with new partners such as Microsoft, Sun Microsystems, Sony, Motorola and General Magic.

## **Direct Costs and Gross Margin**

Direct costs consist primarily of the cost of product media and duplication, the cost of packaging materials and shipping expenses. Costs associated with non-recurring engineering fees are included in research and development expenses and are not separately identified. Direct costs increased from \$207 in fiscal 1994 to \$827 in fiscal 1995 and increased 189% from fiscal 1995 to \$2,389 in fiscal 1996, representing 10%, 16% and 22% of revenue, respectively. The increase in direct costs from fiscal 1994 to fiscal 1995 was due primarily to the continued growth in revenue derived from CodeWarrior product sales.

The increase in direct costs for 1996 is, in part, due to royalties paid by the Company in 1996 under the terms of technology agreements with Sun Microsystems and Microsoft, entered into in fiscal 1996. In addition, the Company's margins were affected by an increase in hardware sales in fiscal 1996, as well as by the introduction of the Discover Programming series of products which have lower gross margins.

## **Operating Expenses**

*Research and Development.* Research and development costs are expensed as incurred. A portion of the eligible software costs incurred between the time a product achieves technological and financial feasibility until its general release to customers are capitalized and amortized on a straight-line basis over the economic life of the product, which is generally three years. The Company evaluates the realizable value of capitalized software on an ongoing basis, relying on a number of factors, including operating results, business plans, budgets and economic projections. In addition, the Company evaluates non-financial data such as market trends and product development cycles. Research and development costs are reduced by investment tax credits.

Research and development costs increased from \$1,080 in fiscal 1994 to \$1,657 in fiscal 1995 and increased 113% from fiscal 1995 to \$3,525 in fiscal 1996, representing 53%, 32% and 33% of revenue, respectively. Research and development expenditures consisted primarily of personnel-related costs. Increases in expenses were due primarily to the growth of the Company's research and development team required to expand and enhance the Company's product line. Research and development personnel totaled 25, 36 and 65 at July 31, 1994, 1995 and 1996, respectively.

*Selling, administrative and technical support.* Selling, administrative and technical support costs increased from \$1,053 in fiscal 1994 to \$2,348 in fiscal 1995 and increased 97% from fiscal 1995 to \$4,622 in fiscal 1996, representing 52%, 46% and 44% of revenue, respectively. This increase in 1995 was due primarily to the opening of new distribution channels, expansion of the direct sales force and adding the additional marketing, administrative and technical support personnel needed to support the Company's growth. The increase in 1996 resulted from the Company's focus on developing the infrastructure necessary to provide support for the Company's growth and expansion into new markets. Selling, administration and technical support personnel totaled 15, 21 and 60 at July 31, 1994, 1995 and 1996 respectively.

### **Provision for Income Taxes**

As a result of accumulated operating losses, the Company did not record any provisions for income taxes in 1994, 1995 or 1996. As of July 31, 1996, the Company had net operating loss carryforwards of approximately \$2,093, which begin to expire in 2001. The Company also had research and development tax credit carryforwards of \$105 as of July 31, 1996, which begin to expire in 2001, as well as unclaimed research and development deductions in the amount of \$1,270 which may be carried forward indefinitely. If the Company continues to remain profitable, such losses, tax credit carryforwards and unclaimed deductions may reduce the amount of taxes payable.

### **Liquidity and Capital Resources**

Since its inception, the Company has financed its cash requirements from cash generated from operations, the sale of equity securities, bank lines of credit and long-term and short-term debt. At July 31, 1996, the Company has cash and marketable securities of \$11,498 and no long-term or short-term debt. Metrowerks had net working capital of approximately \$13,519 at July 31, 1996, compared to \$4,742 at July 31, 1995.

In fiscal 1995, the Company's operating activities generated net cash of approximately \$783. This resulted primarily from net earnings of \$254, non-cash expenses of \$242 and net changes in non-cash working capital of \$287. On May 4, 1995, the Company completed a special warrant offering, which raised net proceeds of \$4,464, after deducting expenses of the offering. The Company used \$960 of the net proceeds to repay indebtedness owed to Société de développement industriel du Québec. The balance of the net proceeds was invested in short-term investments and ultimately used by the Company as

working capital to fund its operations which included expenses for research and development of new and existing products, in a manner consistent with that previously publicly disclosed by the Company.

In fiscal 1996, the Company's operating activities consumed cash of approximately \$1,290. During fiscal 1996, the Company entered into reseller agreements with Ingram Micro and Merisel, which reduced the percentage of product sold directly by the Company. In addition, the Company expanded the number of international distributors carrying its products in fiscal 1996, and the volume of business in international markets increased from \$856 in fiscal 1995 to \$2,079 in fiscal 1996. The effect of these developments resulted in an increase in receivables due from distributors. The Company has continued to make investments in technology and had cash expenditures of \$1,714 in fiscal 1996 for property and equipment. In March 1996, the Company completed an offering of 1,000,000 common shares for net proceeds of \$10,341 to obtain the financial resources needed for execution of its expansion into the embedded systems, Windows and Java markets.

## MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The financial statements and other information contained in this Annual Report are the responsibility of Management. They have been prepared in accordance with generally accepted accounting principles and present fairly the consolidated financial position, results of operations and changes in financial position of the Company. Where necessary, Management has made informed judgements and estimates of the outcome of events and transactions, with due consideration given to materiality.

As a means of fulfilling its responsibility for the integrity of financial information included in this Annual Report, Management relies on the Company's system of internal control. This system has been established to ensure, within reasonable limits, that the assets are safeguarded, that transactions are properly recorded and executed in accordance with Management's authorization and that the accounting records provide a solid foundation from which to prepare the financial statements.

The Company's independent public accountants are responsible for auditing the financial statements and giving an opinion on them. As part of that responsibility, they review and assess the effectiveness of internal accounting controls to establish a basis for reliance thereon in determining the nature, timing and extent of audit tests to be applied. Management emphasizes the need for constructive recommendations as part of the audit process.

The Board of Directors carries out its responsibility for the consolidated financial statements principally through its Audit Committee, consisting solely of outside directors, which reviews the financial statements and reports thereon to the Board. The Committee meets periodically with the independent public accountants and Management to review their respective activities and the discharge of their responsibilities. The independent public accountants have free access to the Committee, with or without Management, to discuss the scope of their audit, the adequacy of the system of internal control and the adequacy of financial reporting.

Management recognizes its responsibility for fostering a strong ethical climate so that the Company's affairs are carried out according to the highest standards of personal and corporate conduct. This responsibility is characterized in the code of business conduct which is publicized throughout the Company.

## INDEPENDENT AUDITORS' REPORT

### Auditors' Report to the Stockholders

We have audited the consolidated balance sheets of Metrowerks Inc. as at July 31, 1994, 1995 and 1996 and the consolidated statements of operations, stockholders' equity and changes in financial position for the years ended July 31, 1994, 1995 and 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at July 31, 1994, 1995 and 1996, and the results of its operations and the changes in its financial position for the years ended July 31, 1994, 1995 and 1996 in accordance with Canadian generally accepted accounting principles.

The image shows a handwritten signature in black ink that reads "Coopers & Lybrand". The script is cursive and fluid, with the ampersand being particularly stylized.

General Partnership  
Chartered Accountants

Montreal, Quebec, Canada  
September 6, 1996

# Metrowerks Inc.

Consolidated Balance Sheets as at July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars)

## Assets

Current assets	1994	1995	1996
Cash and short-term deposit	64	159	1,300
Marketable securities - at cost which approximates market	703	4,587	10,198
Accounts receivable	314	560	2,838
Inventories	10	64	254
Income and other taxes recoverable	95	237	224
Prepaid expenses and other assets	82	198	573
<b>Total current assets</b>	<b>1,268</b>	<b>5,805</b>	<b>15,387</b>
<b>Property and equipment - net (note 3)</b>	<b>291</b>	<b>357</b>	<b>1,716</b>
<b>Software development costs</b> net of accumulated amortization of nil, \$83, \$358	<b>133</b>	<b>472</b>	<b>1,202</b>
<b>Total assets</b>	<b>1,692</b>	<b>6,634</b>	<b>18,305</b>
<b>Liabilities and Stockholders' Equity</b>			
<b>Current liabilities</b>			
Accounts payable	151	493	1,129
Accrued liabilities (note 4)	67	487	550
Deferred revenue	—	83	189
Current portion of long-term debt	202	—	—
<b>Total current liabilities</b>	<b>420</b>	<b>1,063</b>	<b>1,868</b>
<b>Long-term debt (note 5)</b>	<b>785</b>	<b>—</b>	<b>—</b>
<b>Commitments (note 7)</b>			
<b>Stockholders' equity</b>			
Capital stock (note 6)	1,855	6,685	17,446
Deficit	(1,368)	(1,114)	(1,009)
<b>Total stockholders' equity</b>	<b>487</b>	<b>5,571</b>	<b>16,437</b>
<b>Total liabilities and stockholders' equity</b>	<b>1,692</b>	<b>6,634</b>	<b>18,305</b>

Signed on behalf of the Board of Directors



**Jean Bélanger**  
Director



**David Perkins**  
Director

See accompanying notes

## Metrowerks Inc.

Consolidated Statements of Stockholders' Equity for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars, except number of shares)

	Common Stock		Special Warrants		Deficit	Total Stockholders' Equity
	Shares	Amount	Shares	Amount		
Balance at July 31, 1993	5,716,767	356	—	—	(1,036)	(680)
Issuance of common stock	2,106,666	1,499	—	—	—	1,499
Net loss	—	—	—	—	(332)	(332)
Balance at July 31, 1994	7,823,433	1,855	—	—	(1,368)	487
Issuance of common stock	353,800	366	—	—	—	366
Issuance of special warrants	—	—	2,000,000	4,464	—	4,464
Net earnings	—	—	—	—	254	254
Balance at July 31, 1995	8,177,233	2,221	2,000,000	4,464	(1,114)	5,571
Conversion of special warrants	2,000,000	4,464	(2,000,000)	(4,464)	—	—
Issuance of common stock	1,319,750	10,761	—	—	—	10,761
Net earnings	—	—	—	—	105	105
Balance at July 31, 1996	11,496,983	17,446	—	—	(1,009)	16,437

See accompanying notes

**Metrowerks Inc.**

Consolidated Statements of Operations for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars, except per share amounts)

	1994	1995	1996
<b>Revenue</b> (note 10)	2,040	5,143	10,619
<b>Direct costs</b>	207	827	2,389
<b>Gross margin</b>	1,833	4,316	8,230
<b>Operating expenses</b>			
Research and development	1,080	1,657	3,525
Selling, administrative and technical support	1,053	2,348	4,622
Depreciation of property and equipment	66	155	355
<b>Total operating expenses</b>	2,199	4,160	8,502
<b>Earnings (loss) from operations</b>	(366)	156	(272)
<b>Other income (expenses)</b>			
Interest income	20	93	375
Interest expense	(35)	(35)	—
Other	49	40	2
<b>Net earnings (loss)</b>	(332)	254	105
<b>Net earnings (loss) per share</b>	\$(0.05)	\$0.03	\$0.01
<b>Weighted average number of common shares outstanding</b>	6,904	7,956	10,620

See accompanying notes

## Metrowerks Inc.

Consolidated Statements of Changes in Financial Position for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars)

	1994	1995	1996
<b>Cash flows from operating activities:</b>			
Net earnings (loss)	(332)	254	105
Adjustments to reconcile net earnings (loss) to net cash provided by (used for) operating activities:			
Depreciation of property & equipment	66	155	355
Amortization of software development costs	—	83	275
Loss on sale of property and equipment	—	4	—
	(266)	496	735
Changes in assets and liabilities -			
Accounts receivable	(301)	(246)	(2,278)
Income and other taxes recoverable	51	(142)	13
Inventories	(10)	(54)	(190)
Prepaid expenses and other assets	(80)	(116)	(375)
Accounts payable	75	342	636
Accrued liabilities	(16)	420	63
Deferred revenue	(123)	83	106
Net cash provided by (used for) operating activities:	(670)	783	(1,290)
<b>Cash flows from investing activities:</b>			
Additions to property & equipment	(193)	(315)	(1,714)
Software development costs	(133)	(422)	(1,005)
Proceeds on sale of property & equipment	—	90	—
Net cash used for investing activities:	(326)	(647)	(2,719)
<b>Cash flows from financing activities:</b>			
Net proceeds from issue of common stock net of issuance costs of \$334, \$— and \$1,504, respectively	1,499	—	10,341
Net proceeds from issue of special warrants	—	4,464	—
Issuance of common stock on exercise of stock options	—	366	420
Repayment of long-term debt	(113)	(987)	—
Net cash provided by financing activities:	1,386	3,843	10,761
<b>Increase in net cash</b>	390	3,979	6,752
<b>Net cash at beginning of year</b>	377	767	4,746
<b>Net cash at end of year</b>	767	4,746	11,498
Net cash consists of:			
Cash and short-term deposit	64	159	1,300
Marketable securities	703	4,587	10,198
	767	4,746	11,498

See accompanying notes

## **Metrowerks Inc.**

Notes to Consolidated Financial Statements for the years ended July 31, 1994, 1995 and 1996

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(in thousands of U.S. dollars)

### **1. Nature of operations**

The Company's principal line of business is the research, design, development, marketing and support of computer software programming tools.

### **2. Significant accounting policies**

#### **Basis of presentation**

These financial statements have been prepared by the Company in accordance with accounting principles generally accepted in Canada (Canadian GAAP), applied on a consistent basis with the previous year. These financial statements would not be materially different if prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

#### **Principles of consolidation**

The consolidated financial statements include the accounts of the Company and its subsidiary. All significant intercompany transactions and balances have been eliminated.

#### **Revenue recognition**

Revenue from sales to distributors and from corporate license programs is recognized when the related products are shipped, when no significant vendor obligations remain, and collection of the receivable, net of provisions for estimated future returns, is probable. Allowances for estimated future software updates are provided for in the same period as the related revenue.

Revenue from product development contracts is recognized ratably over the term of the related contract.

#### **Cash equivalents, short-term investment and marketable securities**

The Company considers investments in highly liquid instruments purchased with maturities of 90 days or less to be cash equivalents. All of the Company's cash equivalents, short-term investments and marketable securities, consisting principally of government guaranteed instruments, are classified as trading securities as of the balance sheet date and are reported at cost which approximates fair market value.

#### **Credit risk**

The Company performs ongoing credit reviews of all its customers and records an allowance for doubtful accounts receivable when accounts are determined to be uncollectible.

#### **Inventories**

Inventories, consisting of product documentation and magnetic media, are stated at the lower of cost and net realizable value. Cost is determined using the average cost method.

## **Metrowerks Inc.**

Notes to Consolidated Financial Statements for the years ended July 31, 1994, 1995 and 1996

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(in thousands of U.S. dollars)

### **2. Significant accounting policies (cont'd)**

#### **Software development costs**

Costs related to research, design and development of computer software are charged to research and development expense as incurred. The Company amortizes eligible software development costs based on current and future revenue with an annual minimum equal to straight-line amortization over the remaining economic life of the product, generally being three years.

The Company evaluates the net recoverable amounts of capitalized software on an ongoing basis, relying on a number of factors including operating results, business plans, budgets and economic projections. In addition, the Company's evaluation considers non-financial data such as market trends and product development cycles.

For the years ended July 31, 1994, 1995 and 1996, amortization expense amounted to nil, \$83 and \$275, respectively.

Research and software development costs are reduced by investment tax credits.

#### **Property and equipment**

Property and equipment are recorded at historical cost. Depreciation of property and equipment is provided for, based on the estimated useful life of the assets using the declining balance method as follows:

Office equipment	20%
Computer equipment	30%
Software	30%

The Company provides for depreciation of leasehold improvements over the term of the related lease. Expenditures for maintenance and repairs are expensed as incurred. Upon retirement or other disposition of assets, the cost and related accumulated depreciation are eliminated from the accounts and the resulting gain or loss is reflected in operations.

#### **Deferred revenue**

Deferred revenue consists of amounts received in advance for product, documentation, magnetic media and development services to be delivered in future periods.

#### **Foreign currency translation**

Monetary assets and liabilities are translated at year-end rates, whereas non-monetary assets and liabilities are translated at rates prevailing at the transaction dates. Revenue and expenses are translated at average month-end rates throughout the year. Currency gains and losses are reflected in the results of operations for the year.

Effective August 1, 1995, the Company changed its reporting currency from Canadian dollars to U.S. dollars. The prior years' financial statements have been restated as if the U.S. dollar had always been the currency of measurement.

## Metrowerks Inc.

Notes to Consolidated Financial Statements for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars)

### 2. Significant accounting policies (cont'd)

#### Advertising costs

Advertising costs are expensed in the first period in which the advertising occurs. For the years ended July 31, 1994, 1995 and 1996, advertising expense amounted to \$74, \$498 and \$1,179, respectively.

#### Net earnings per common share

The net earnings per common share figures are calculated using the weighted monthly average number of common shares outstanding during the year.

### 3. Property and equipment

Property and equipment consist of the following:

	1994		
	Cost	Accumulated amortization	Net
Office equipment	41	9	32
Computer equipment	184	56	128
Software	27	—	27
Leasehold improvements	5	1	4
Assets held for resale	125	25	100
	382	91	291
	1995		
	Cost	Accumulated amortization	Net
Office equipment	63	20	43
Computer equipment	440	170	270
Software	60	18	42
Leasehold improvements	7	5	2
	570	213	357
	1996		
	Cost	Accumulated amortization	Net
Office equipment	464	62	402
Computer equipment	1,288	403	885
Software	505	91	414
Leasehold improvements	17	2	15
	2,274	558	1,716

## Metrowerks Inc.

Notes to Consolidated Financial Statements for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars)

### 4. Accrued liabilities

	1994	1995	1996
Accrued compensation and related costs	8	93	241
Professional costs	7	302	115
Upgrade provision	27	67	59
Other	25	25	135
	67	487	550

### 5. Long-term Debt

	1994	1995	1996
The long term debt is comprised of the following:			
Société de développement industriel du Québec Loan No.1	223	—	—
Société de développement industriel du Québec Loan No.2	648	—	—
Mortgage loan bearing interest at 9%, repayable in monthly installments of \$1,548, including interest, repaid during the year	116	—	—
	987	—	—
Less: Current portion:			
Société de développement industriel du Québec Loan No.1	—	—	—
Société de développement industriel du Québec Loan No.1	199	—	—
Mortgage loan	3	—	—
	202		
	785		

The Société de développement industriel du Québec Loan No.1 and No.2 were granted to the Company to finance various development costs. The loans bore interest at subprime rates plus royalty amounts on gross sales. On May 26, 1995 both loans were paid in full. As a condition of the payment of the loans, the Company received a discharge of any royalty obligations.

### 6. Capital stock

	1994	1995	1996
Unlimited as to number, with no par value -			
Class A preferred stock, none outstanding			
Class B preferred stock, none outstanding			
Common stock, issued - 11,496,983			
(1995 - 8,177,233 1994 - 7,823,433)	1,855	2,221	17,446
Special warrants, nil issued			
(1995 - 2,000,000 1994 - nil)			
converted during the year at no additional cost, at a rate of one common stock per special warrant	—	4,464	—
	1,855	6,685	17,446

#### Preferred shares

The Class A preferred shares are non-voting, non-cumulative preferred shares, redeemable at the option of the Company or the holder at their stated amount. Dividends on Class A shares, having priority over all other classes of shares may be paid at the discretion of the Board of Directors up to a maximum of 10% of the stated capital.

## Metrowerks Inc.

Notes to Consolidated Financial Statements for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars)

### 6. Capital stock (cont'd)

The terms of the Class B preferred shares will be determined by the Board of Directors at the time of issuance of the shares.

As at July 31, 1996, and all prior year-ends, there were no issued Class A and Class B shares.

#### Stock option plan

The Company maintains an incentive stock option ("ISO") plan for the benefit of officers and employees. The exercise price of the ISO stock option is the fair market value of the shares as at the date of the grant. Stock options generally become vested ratably over a three-year period.

Stock options outstanding were as follows:

	Price per share (in Canadian dollars)		
	Number	Range	Weighted average
Balance at July 31, 1993	367,000	1.50	
Granted	130,000	1.50 - 1.85	1.62
Exercised	—	—	—
Cancelled	—	—	—
Balance at July 31, 1994	497,000	1.50 - 1.85	1.53
Granted	348,750	1.55 - 6.25	2.66
Exercised	(153,800)	1.50 - 6.25	2.15
Cancelled	(79,000)	1.50 - 1.55	1.61
Balance at July 31, 1995	612,950	1.50 - 6.25	2.15
Granted	443,050	5.25 - 18.25	9.64
Exercised	(317,250)	1.50 - 5.25	1.83
Cancelled	(124,600)	1.55 - 18.25	5.65
Balance at July 31, 1996	614,150	1.50 - 18.25	7.01

### 7. Commitments

The Company leases various facilities under non-cancellable operating leases. Minimum future lease commitments under non-cancellable operating leases for facilities in effect as at July 31, 1996, over the next two years are presented as follows:

Year ending July 31,	1997	333
	1998	86

Total rent expense for operating leases was \$37, \$69 and \$139 for the years ended July 31, 1994, 1995 and 1996, respectively.

The Company engages the services of individual contractors to assist in research and development related to the Company's software products.

## Metrowerks Inc.

Notes to Consolidated Financial Statements for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars)

### 8. Research and development

Research and development expenditures consist of:

	1994	1995	1996
Expenditures	1,278	2,196	4,324
Amortization of capitalized software development expenditures	—	83	275
Total expenditures	1,278	2,279	4,599
Less: Capitalized software development expenditures (net of research and development tax credits)	133	422	1,005
Investment tax credits	65	200	69
	1,080	1,657	3,525

### 9. Income taxes

The Company has incurred non-capital losses and other timing differences of approximately \$2,093 and \$1,133, respectively, for tax purposes which may be carried forward and used to reduce taxable income in future years and for which no future benefit has been recognized in the accounts. The non-capital losses may be claimed no later than:

Year ending July 31,	2000	85
	2001	415
	2010	43
	2011	1,550
		<u>2,093</u>

The difference between the actual income tax provision and the tax provision computed by applying the statutory income tax rate to earnings (loss) before taxes is attributed to the following:

	1994 %	1995 %	1996 %
Statutory tax rate	37.74	37.86	38.01
Future benefit of timing differences not recognized	(29.92)	(42.97)	(17.49)
Permanent differences	(7.82)	5.11	(20.52)
	—	—	—

## Metrowerks Inc.

Notes to Consolidated Financial Statements for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars)

### 10. Revenue

Revenue is comprised of the following:

	1994	1995	1996
Product	1,469	4,044	7,246
Development contracts	495	613	2,263
Hardware	—	152	554
Other	76	334	556
	2,040	5,143	10,619

### 11. Geographic data

The Company operates in one business segment (see note 1). The Company's revenues by geographic location are as follows:

	1994	1995	1996
Revenue			
United States	1,333	4,029	8,500
Canada	606	258	40
Japan	69	512	567
Other	32	344	1,512
	2,040	5,143	10,619

The Company's assets by geographic location are as follows:

United States	—	270	4,466
Canada	1,692	6,376	17,990
Intercompany eliminations	—	(12)	(4,151)
	1,692	6,634	18,305

### 12. Differences between Canadian and U.S. generally accepted accounting principles

#### (a) General

Accounting principles adopted in these financial statements are generally consistent with accounting principles generally accepted in the United States (U.S. GAAP). These financial statements would not be materially different if prepared in accordance with U.S. GAAP.

#### (b) Income taxes

The United States' Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" which became effective for years beginning after December 15, 1992. The Company has determined that the adoption of this Statement would have no material effect on assets, liabilities, or operations for the years presented in these consolidated financial statements.

## Metrowerks Inc.

Notes to Consolidated Financial Statements for the years ended July 31, 1994, 1995 and 1996

(in thousands of U.S. dollars)

### 12. Differences between Canadian and U.S. generally accepted accounting principles (cont'd)

#### (c) Stock options

In October 1995, the United States' Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-based Compensation", which is effective for 1997. Under SFAS 123, companies can elect, but are not required to recognize compensation expense for all stock-based awards, using a fair-value methodology. The Company expects to implement in 1997 the disclosure only provisions, as permitted by SFAS 123.

#### (d) Earnings (loss) per common share

Under U.S. GAAP, primary earnings (loss) per common share is calculated using the treasury stock method. The calculation of primary earnings (loss) per common share under U.S. GAAP would not be materially different than the earnings (loss) per common share calculated under Canadian GAAP.

#### (e) Statement of cash flows

Under U.S. GAAP, marketable securities are excluded from the definition of net cash on the statement of cash flows and, instead, are included as an investing activity. Accordingly, the increase in net cash and investing activities under U.S. GAAP would be lowered by the following amounts each year:

	1994	1995	1996
Marketable securities	(703)	(3,884)	(5,611)

#### (f) Supplementary U.S. GAAP disclosure

	1994	1995	1996
Interest paid	35	35	—
Taxes paid	—	—	—

## BOARD OF DIRECTORS

(1) Audit Committee (2) Compensation Committee (3) Stock Option Committee

Jean J. Bélanger <sup>(2) (3)</sup> Chairman and Chief Executive Officer Austin, Texas	Gregory P. Galanos <sup>(3)</sup> President and Chief Technology Officer Cupertino, California
Louis Lacasse <sup>(1)</sup> Vice President, SOFINOV Société financière d'innovation Inc. Montreal, Canada	Tom Woods <sup>(1) (2)</sup> Managing Director, CIBC Wood Gundy Securities Inc. Toronto, Canada
David Perkins Senior Vice President, Strategic Products Austin, Texas	Stephen O. Lockyer <sup>(1) (2) (3)</sup> President, Cornwallis Financial Corporation Halifax, Canada

## OFFICERS

Jean J. Bélanger Chairman and Chief Executive Officer	Gregory P. Galanos President and Chief Technology Officer
David Perkins Senior Vice President, Strategic Products	Berardino Baratta Vice President, Research & Development
Robert Geier Vice President, Sales	Jim Welch Vice President, Finance and Chief Financial Officer

Shareholders are invited to attend the Annual General Meeting at 11 a.m. on Monday, October 28, 1996,  
at The Toronto Hilton Downtown, 145 Richmond Street West, Toronto, Canada

## STOCK EXCHANGE LISTINGS

Metrowerks Inc. shares are traded publicly  
on the NASDAQ Stock Market and the Toronto  
and Montreal Stock Exchanges.

## TRADING SYMBOL

MTWKF (NASDAQ), MWK (TSE, ME)

## TRANSFER AGENT AND REGISTRAR

Montreal Trust Company of Canada  
The Bank of Nova Scotia Trust, New York

## SOLICITORS

Tory Tory DesLauriers & Binnington  
Toronto, Canada

Fenwick & West LLP  
Palo Alto, California

## AUDITORS

Coopers & Lybrand  
Austin, Texas  
Montreal, Canada



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